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## Is it Time to Re-think the WTO? A Return to the Basics

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The GATT was an organization that was seldom at the centre of political controversy, nor was it the object of virulent protest. The WTO, which succeeded it, however, has not enjoyed the GATT's anonymity. The controversies surrounding the WTO detract from its effectiveness and debase its credibility. In large measure, the contentious issues that the WTO has been attempting to deal with since its inception do not have at their heart trade in goods and services. The framers of the WTO took bold steps to create a new institution during the Uruguay Round—much of which has turned out to be a significant improvement on the GATT. This does not mean, however, that everything that was put in place has proved to be an improvement, or even workable. It may be time to consider returning the WTO to its basic function—providing a set of rules for the conduct of trade in goods and services.

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### Introduction

It is often forgotten in the midst of the nationalist or anti-nationalist rhetoric in media coverage of the World Trade Organization (WTO) that it is firms that engage in international commercial transactions—countries do not engage in trade.<sup>1</sup> International trade is simply the aggregation of the fruits of those transactions on a national basis. Trade is the result of a firm in one country identifying a business opportunity in another country and then organizing a commercial transaction to act on that opportunity. If a firm in London

sees a commercial opportunity to sell its goods to a firm in Manchester, no one pays any attention. If that same London firm finds a similar opportunity to sell an identical good to a company based in New York, all manner of groups—not the least of whom are politicians—feel they have a duty, and a right, to comment on and otherwise become involved in the transaction.

Governments strongly guard the right to tax, limit, and in other ways regulate international transactions in ways that differ from their interventions in domestic commerce. One of the reasons for this is that they have no authority to monitor production and commercial practices in foreign countries. An equally important reason, however, is the ability to extend protection from foreign competitors to domestic petitioners. While most politicians believe that open international markets are generally beneficial, they do not believe this is true in all circumstances, and they certainly understand that politically important constituents may be harmed by international competition. Ideally, politicians would like the flexibility to extend protection easily to their constituents when it is politically expedient.

For firms wishing to engage in international commerce, however, the unconstrained and arbitrary ability of governments to impose restrictions on their transactions represents a considerable risk. Transactions, and, more important, investments made in support of anticipated transactions, are based on calculations of expected profitability. Once a foreign transaction is entered into or an investment is made to support future foreign activities, having the commercial conditions upon which those decisions were arrived at altered by an arbitrary change in trade policy by foreign governments can lead to considerable financial losses. Under these conditions, international transactions are shunned and investments inhibited. As a result, the potential benefits from international trade forgone exceed by large orders of magnitude the losses suffered by those who may be directly affected by the imposition of trade barriers in specific markets.

Firms that wish to engage in international commerce desire strong and transparent rules that constrain the ability of governments to impose trade barriers. The framers of the New World Order at the end of the Second World War had lived through the *beggar thy neighbour* trade wars of the Great Depression of the 1930s and had seen first hand the effects of virtually unconstrained and arbitrary protectionism (Kerr, 2000). They decided that a new international institution was required to facilitate the establishment of international rules for government intervention in international commercial activities. While a comprehensive International Trade Organization (ITO) was negotiated as part of the broad process that created the United Nations, the International Monetary Fund and the World Bank, it did not come into being, largely because U.S. congressional politicians would not accept the degree of discipline on their protectionist prerogatives that the U.S. Administration had conceded in the negotiations (Hart, 1998). One of the ITO's subagree-

ments, the General Agreement on Tariffs and Trade (GATT), became, by default, the premier international organization for negotiating and administering rules for trade. The GATT was exclusively concerned with trade in goods and had a primary focus on border measures and their reduction. Only in the penultimate Tokyo Round of GATT negotiations that ended in 1979 was there a concerted effort to expand the role of the organization beyond its traditional concerns.

At any point in time, the GATT represented the current state of the international compromise between the desire of politicians to provide security for firms that wished to engage in international commerce and their need for flexibility in the ability to extend protection to domestic constituents. The GATT principle of *accepted retaliation* has always provided domestic politicians with the ability to ignore GATT disciplines when the domestic political pressure to extend protection became too great—but not without a cost (Kerr and Perdakis, 1995). In fact, the entire history of the GATT can be viewed as a long process of raising the cost of extending protection by both increasing the scope of activities to which GATT disciplines applied and by tightening up the existing disciplines. The objective was to provide firms wishing to engage in international commerce with increased surety for their investments.

## Changing Realities

Over the fifty-odd years of its existence, the GATT organization was successful in lowering the major barrier to international trade that existed when it came into being—tariffs. The reduction in tariffs contributed to the growth in international trade, and the increased surety for investments in international commerce provided a spur to research and development in international transport technology and packaging and in new transaction-cost-reducing financial and insurance instruments. In addition, international commerce benefited disproportionately from the revolution in computer and electronic information transfer technology that has been manifest since the mid-1980s. The combined result of these changes is the trend toward what has been termed *globalization*.

The GATT, however, seemed increasingly incapable of dealing with the challenges provided by globalization. In particular, its mandate was restricted to trade in goods while the fastest growing sector of most economies was services. The reduction of tariffs had exposed a multitude of domestic regulations that acted to restrict trade. The consensus-based dispute settlement system had been designed for an organization constituted as a forty-odd member *club*

inhabited by diplomats of impeccable reputation who would ensure that its affairs would be conducted with all seemly propriety. Should any unhappy differences arise they would be settled privately according to the feelings of the general consensus (*Journal of World Trade Law*, 1981, 469).

The dispute settlement system was no longer appropriate for an organization that had grown to 120-plus members encompassing a wide range of political and economic philosophies.

The Uruguay Round (1986-1993) set about to rectify this situation. Services were now encompassed through the General Agreement on Trade in Services (GATS), stronger disciplines on non-tariff barriers and subsidies were hammered out, and a new dispute settlement mechanism was established based on an arbitration model that did not require consensus. All of this should have provided greater surety for firms wishing to engage in international commerce.

### **Trade Sanctions as a Weapon in International Relations**

Trade barriers can be used for purely economic reasons—to reduce the competitiveness of imported products. The GATT was primarily an organization that made rules regarding the use of trade barriers for protectionist motives. Trade barriers can, however, also be viewed as a means of achieving other goals—to sanction foreign governments for activities that are considered unacceptable by the party imposing the trade barrier (Kerr and Gaisford, 1994). Trade barriers impose costs on the economy of the country judged to be following unacceptable practices. It is hoped by the imposing country that these costs will be sufficient inducement for the offending country to alter its practices. The most obvious examples of the use of trade sanctions for political reasons are their imposition by the international community on countries such as Iraq after the Gulf War, Serbia after the break-up of Yugoslavia, and apartheid-era South Africa. The United States has applied trade sanctions against Cuba for decades. Thus, trade barriers represent the middle ground along the continuum of international inducements that can be used by governments when they attempt to influence the activities of other governments. At one end of the continuum is diplomatic pressure and at the other is military force.

Diplomatic sanctions are not likely to alter the practices of a determined adversary. War carries high costs, potentially in human lives and certainly in mounting a foreign campaign and in material losses for the country attacked. War is also politically risky. Trade sanctions can impose real costs but, for the most part, carry low political risk.<sup>2</sup> The potential to use trade sanctions as a way to threaten countries into changing their practices has not been lost on groups in society with vested economic interests or who have strongly held preferences. One example of the latter is environmental activists. Environmental groups have been successful in the United States in getting trade sanctions embedded into domestic environmental regulations pertaining to the protection of marine mammals and other aquatic species. For example, countries which do not comply with the International Whaling Commission are threatened with U.S. trade sanctions, as are those who by U.S.

standards do not fish for tuna in a dolphin-friendly fashion or fish for shrimp in ways that threaten turtles, etc. Unilaterally, the United States has had considerable success in threatening countries into altering their high seas resource management practices (Gordon et al., 2000).

Environmental groups have been particularly frustrated by what they perceive as the ineffectiveness of using international diplomacy to police poor environmental management. Collectively, they have put tremendous efforts into the process of reaching Multilateral Environmental Agreements (MEAs) such as the Rio Convention and the Kyoto Protocol, only to find that there is little beyond diplomatic pressure that can be applied against countries that fail to live up to their commitments. They desire more effective means to induce countries to live up to their commitments. Trade sanctions are an obvious choice. One international organization that can legitimately impose trade sanctions is the WTO. Thus, while some of the demonstrators in Seattle were railing against the WTO and calling for its demise, major environmental NGOs were demanding a seat at the WTO table. They were asking for direct input into the negotiation process. While the NGOs were not directly successful in their attempts, the WTO is giving considerable thought to how *civil society* can be accommodated in the organization's deliberations. The WTO, with its ability to impose trade sanctions, is a coveted prize that may be open to capture. The capture of international organizations is not unprecedented—the International Whaling Commission, which is supposed to manage commercial whaling activities, has effectively been captured by those with an interest in having commercial whaling banned. The WTO is simply a more desirable target.

While the potential capture of the WTO by environmental and other *civil society groups* may seem far-fetched, it is not without precedent, as illustrated by the case of intellectual property protection. The proportion of the value of goods comprised of intellectual property has been increasing steadily over the past two decades. Further, the ability to produce intellectual property is clearly seen as a major determinant of economic growth and of relative economic performance internationally. To maintain their leadership in the global economy, countries must be on the leading edge of technological development. Piracy of intellectual property reduces the incentive for firms to invest in its development and, thus, threatens countries' long-term economic performance.

Prior to the Uruguay Round the World Intellectual Property Organization (WIPO) was the international organization responsible for intellectual property protection. It is similar to an MEA in that it has no enforcement capability other than the diplomatic pressure that could be brought to bear. Many developing countries did not belong to WIPO. Those with a vested interest in protection of intellectual property, largely firms and governments in

developing countries, wanted a means to impose costs on countries that did not protect intellectual property. The instrument chosen was the GATT. The Uruguay Round negotiations produced the Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) which established standards of intellectual property protection for its members. Further, the negotiations led to the agreement to establish the WTO to administer the TRIPS as well as the GATT. A central element of the WTO was that it would administer one dispute settlement system covering both agreements.<sup>3</sup> A major reason for this unified dispute system, and for that matter the structure of the WTO, is to allow for cross-agreement retaliation. This means that countries can impose trade restrictions (through the GATT) on imports of goods from countries that fail to live up to their commitments to protect intellectual property in the TRIPS. Further, to belong to the WTO and receive the benefits of the GATT, all countries had to agree to sign the TRIPS. Thus, those with a vested interest in the protection of intellectual property were successful in obtaining trade sanctions as a legitimate international policing mechanism. In essence, they were able to capture the GATT and reconstitute it to help achieve their goals. There was a period of grace allowed for developing countries to put TRIPS compliant intellectual property regimes in place, but that has now expired and the United States has recently served notice that it intends to bring TRIPS cases forward to the WTO's dispute settlement system.

The protection of intellectual property is not an international trade issue despite the phrase "Trade-Related Aspects" being embedded in the TRIPS' title. International movements of counterfeit goods could easily be handled without the TRIPS. The inclusion of the TRIPS in the WTO clearly moved the GATT, which was primarily an organization that made rules for trade, into an international policing role. Trade barriers can now be imposed on imports from countries that do not live up to their TRIPS commitments. The barriers will be put in place on products at the discretion of the importing country. This increases the risks associated with investing in international commercial activities—contrary to the intent of the original GATT.<sup>4</sup>

It is probably not surprising that groups in *civil society* see the WTO as a prize that is open to capture. They have a precedent to follow. Relative to the GATT, with its consensus-based dispute settlement system, the WTO is a more desirable target because it has a relatively automatic dispute settlement system that can be used to threaten countries with trade sanctions. It was designed that way.

It would no doubt be very difficult to remove the TRIPS from the WTO and return the organization to its role of being exclusively concerned with commercial policy. This could only be done through a more general initiative to deal with the issue of the sanctioning role of trade barriers. A first step would be to deal with the question of defining the relationship between MEAs and the WTO. While the WTO's Committee on Trade and the Environment

is attempting to do this, it has no real mandate to deal with the central issue of trade sanctions—nor should it. It serves no good purpose for the WTO to become mired in questions relating to the sanctioning of countries that do not practice “good” environmental management, or, for that matter, enforce “good” labour standards or “good” animal welfare procedures. The WTO has consistently stated that it does not have the competence to deal with these issues. Without a clear separation of the sanctioning role of trade restrictions from the commercial rules of trade, the WTO will be drawn into what are essentially political conflicts. One of the major irritants for environmental groups is the dismissal by the WTO dispute settlement system of U.S. trade sanctions imposed for marine mammal management reasons on a technicality. The WTO ruled that trade sanctions cannot be imposed for reasons to do with the processes used in production, and fishing methods are processes. The process rule has a good commercial reason for being incorporated in the WTO—to prevent countries from raising trade barriers in cases where foreign firms use a different (and more efficient) technology. It was not intended to control the use of trade sanctions imposed for environmental reasons.

### **New Groups Desiring Protection**

If the WTO could be disentangled from the trade sanction issue, there are a number of issues it should deal with. When the GATT was established, only one group was perceived as asking for protection—producers. The entire GATT system was premised on limiting governments’ ability to extend protection to producers. It seems increasingly evident that other groups are asking for protection from imports. Consumers and environmental groups both lobby forcefully for protection. This has been most evident recently over the issue of genetically modified organisms (GMOs) (Kerr, 1999; Perdakis, 2000). It is showing up increasingly in issues that the WTO is being asked to deal with—eco-labelling, animal welfare, beef produced using growth hormones, child labour, dolphin-friendly tuna, leghold traps, etc. These issues should not be confused with trade sanctioning although they may be parts of the same problem. Environmentalists wishing to be informed as to the fishing practices used to catch imported tuna, or even asking that tuna fished according to certain methods be excluded from their market, is different from using trade sanctions to threaten countries into adopting and enforcing new environmental regulations. Similarly, consumers wishing to be informed of the animal welfare standards (a production process) used to produce imported meat products is different from asking for trade sanctions to force countries to increase their standards. The former must be dealt with by the WTO, as it is an issue of protection (Perdakis and Kerr, 1999). The Uruguay Round agreements on Sanitary and Phyto-sanitary Measures (SPS) and Technical Barriers to Trade were negotiated from the traditional GATT perspective that only producers would ask for protection.

The SPS, with its science-based approach, seems well suited to preventing the extension of protection to producers through the use of arbitrary or overly demanding health or sanitary regulations. It is not, however, appropriate to deal with consumer concerns. This is illustrated by the EU's unsuccessful attempt to use the SPS to justify the exclusion from its market of beef produced using hormones. Consumers' nonacceptance of the scientific evidence relating to the safety of beef produced using hormones make this a consumer issue in the EU (Kerr and Hobbs, 2000). Dealing with consumers, environmentalists and others in the *civil society* who may be demanding protection from their politicians is a major challenge for the WTO. It is made all the more difficult because these issues are often also areas where the use of sanctions is raised as a possibility. Until the WTO can set itself apart from the sanctioning role of trade restrictions, it will be difficult to make progress on these important commercial trade issues.

## Conclusion

The Uruguay Round made a number of overdue improvements to the GATT that changed it from the "club" model that may have been appropriate to the early years of its existence to that of a modern organization that more closely reflects the current political and commercial reality. In the process, however, through the inclusion of the TRIPS and cross-agreement retaliation in the dispute settlement system, the WTO was given a mandate to use trade barriers in a sanctioning role. Including sanctions for violations of intellectual property within the WTO's mandate has altered fundamentally the nature of the new organization and has made it a target for others with an interest in trade sanctions. Ironically, giving the WTO an effective dispute settlement mechanism has increased its desirability as an institution to be captured. While there may be good reasons for changing the nature of GATT during its metamorphosis into the WTO, the outcome runs counter to the basic intent of the GATT—to reduce the risks associated with governments imposing trade sanctions for firms wishing to invest in international commercial activities. It is unlikely that this was intended. Hence, in the post-Seattle interlude, it may be wise to rethink the WTO.

## Endnotes

1. Of course, state trading agencies exist and are important for organizing international transactions in some countries.
2. Trade sanctions, however, may not be particularly effective. See Kerr and Gaisford (1994) for a discussion of the efficacy of trade sanctions.
3. The WTO also administers the General Agreement on Trade in Services (GATS), which also comes under its unified dispute system.
4. The efficacy of imposing trade sanctions on developing country governments for TRIPS violations has, however, been questioned (Yampoin and Kerr, 1998).



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